Bank of England rode to government’s rescue as gilt markets froze

Philip Aldrick, Economics Editor
Thursday April 30 2020, 12.01am, The Times

Sir Robert Stheeman feared an uncovered, or failed, auction of government securities in March

The government was hours from its first failed debt auction in 11 years last month and would have struggled to pay for its lockdown rescue package had the Bank of England not come to its aid, the head of its financing division has revealed.

Sir Robert Stheeman, chief executive of the Debt Management Office, said that his department had completed a £3.25 billion auction of gilts by the skin of its teeth on March 19. Within two hours of the 10.30am issue, the market froze.

“We were very lucky to get away with that auction. A few hours later and we could have had an uncovered auction,” Sir Robert told *The Times*. The last uncovered auction was in March 2009.

The Bank responded to the market crisis immediately. It called an emergency meeting that morning at which it cut rates to 0.1 per cent and launched £200 billion of quantitative easing. “Had the Bank not stepped in, things would have got very difficult,” he said.

The DMO raises the debt to pay for spending plans and is central to the coronavirus rescue effort. The Treasury has asked it to raise £225 billion in four months to pay for everything from furloughed wages to small business grants.

The Office for Budget Responsibility estimates the outbreak will cost £230 billion, directly in £100 billion of policy support and indirectly in the £130 billion impact of the recession. In all, the DMO is projected to raise £381 billion this year, including refinancing old debt, far above the previous record of £228 billion in 2009-10.

Sir Robert, 60, said that the crisis in markets was so pronounced that he feared the DMO would be unable to raise the money required. "My worry is the ability to carry out my mandate, to raise the funds the government needs," he said. "There was that bad period in March where my worry was that liquidity would not be there. The Bank's actions were critical to fixing that."

On April 9, the Treasury announced that it was extending the use of its "ways and means" overdraft facility with the Bank as a back-up in case markets fail again. Since the Bank launched its £200 billion QE programme, "the market has settled down", Sir Robert said.

"It has got used to the notion that there is one large seller in the primary market — us — and in the secondary market there is one very large source of demand — the Bank. That has established an equilibrium that has given market makers the confidence that it is now a safe market in which to operate."

The DMO is issuing between £12 billion and £13 billion of gilts a week and the Bank is buying about £13.5 billion of gilts in the secondary market. At present asset purchase rates, the Bank will have spent all £200 billion by July. It may announce more QE because the DMO is due to issue £60 billion of gilts in July. The match between supply and final demand has brought down the cost of government borrowing.

"Without the Bank buying, yields would likely have been massively higher than now," Sir Robert said.